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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

NO. .....

MILLER BOX, INC., and NORTHPORT BOX, INC.,
Petitioners

v.

UNITED STATES OF AMERICA,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

OPINIONS BELOW

The District Court's instructions to the jury are not officially reported. The opinion of the Court of Appeals (Appendix A, infra, p. 17) is reported at 488 F.2d 695. It is unofficially reported in CCH, Federal Tax Reporter, USTC Advance Sheets, Par. 9195.

JURISDICTION

The judgment of the Court of Appeals (Appendix B, infra, p. 41) was entered on January 23, 1974. The order denying rehearing (Appendix C, infra, p. 42) was entered on February 22, 1974. The jurisdiction of this court is invoked under 28 USC 1254 (1).

QUESTIONS PRESENTED

1. Do the Seventh Amendment to the Constitution of the United States and Rule 50 (b), Federal Rules of Civil Procedure, preclude the Court of Appeals from directing entry of a judgment notwithstanding the verdict, where the verdict loser failed to file timely a motion for judgment notwithstanding the verdict in the trial court?

2. Was the evidence sufficient to go to the jury on the question of the reasonableness of the compensation paid to two employees under contingent employment contracts?

CONSTITUTIONAL PROVISIONS, STATUTES, REGULATIONS, AND FEDERAL RULES INVOLVED

United States Constitution, Amendment VII:

> "In suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury shall be otherwise re-examined in any court of the United States, than according to the rules of the common law."

Statute and Regulations:

> The relevant provisions of the Internal Revenue Code of 1954 (26 U.S.C. 1964 ed., § 162) and of Treasury Regulations on Income Tax (1954 Code) 26 C.F.R. § 1.162-7 are set forth in Appendix D, infra, p. 43.

Rules:

> The text of Rule 50 (b), Federal Rules of Civil Procedure, is set forth in Appendix E, infra, p. 45.

STATEMENT OF THE CASE

These two cases involve the allowance of a deduction for federal income tax purposes of reasonable compensation to two employees paid by taxpayer, Miller Box, Inc., for its fiscal year ended February 28, 1967 and by taxpayer, North-

port Box, Inc., for its fiscal year ended November 30, 1967. Claims for refund were duly filed and denied, and taxpayers brought the separate actions in the District Court. The pretrial order states, "The issue to be consolidated for trial is that relating to the reasonableness of compensation paid by each of the two corporate taxpayers to certain of its officers or employees."

The two employees involved and the compensation in issue for the aforesaid fiscal years are:

Miller Box, Inc.

	Compensation Paid	Director's Determination	Jury Verdict
George L. Hinton, Jr.	$197,372	$60,000	$197,372
Gordon Miller, Jr.	49,343	41,000	49,343
Northport Box, Inc.			
George L. Hinton, Jr.	287,804.92	30,000	287,804.92
Gordon Miller, Jr.	71,951.23	41,000	71,951.23

The jury returned a special verdict in favor of each of the taxpayers, finding that the amounts paid to the employees in question were reasonable compensation for the tax year in issue.

The verdict of the jury was received on September 6, 1972. On September 18, 1972 the Government filed motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On November 7, 1972, separate judgments in favor of each taxpayer were entered by the trial judge for the amount of income tax and interest erroneously collected for the fiscal year in issue. No final judgment was entered on the verdict in favor of Miller Box, Inc. for its fiscal year ended February 29, 1968 because of a further claim remaining to be tried.

On appeal by the Government, the Court of Appeals reversed the judgment of the District Court and remanded

the case for further proceedings not inconsistent with its opinion. The opinion (Appendix A, infra, p. 40) states:

> "This leaves no alternative to this Court but to conclude that the Director's determination as to reasonable salaries for the persons and taxpayers concerned must stand."

Miller Box, Inc. — Employment Contracts

The compensation to George Hinton and Gordon Miller, Jr. by this taxpayer, as stipulated and admitted by the Government, was paid pursuant to employment contracts providing for compensation based respectively on 20 per cent and 5 per cent of taxpayer's net earnings before taxes during the fiscal year, beginning March 1, 1966.

The contract between taxpayer and George had its genesis in a written employment contract between George and his brother, James, entered into on December 22, 1965.

James in late 1965 had been informed by a third party of negotiations being conducted by one Rice with George to secure George's "know how" in the box business and of Rice's offer to furnish facilities and the necessary money and to give George 50 per cent of the partnership profits without capital contribution. He took action to bind George contractually to a two-year, non-compete agreement to become manager of a box plant which James or a corporation to be formed by him would build, and compensate him on the basis of 20 per cent of the net profits thereof before taxes.

James was fully aware of George's proficiency and experience in the manufacture of ammunition boxes in the Korean War and as a partner in and general manager of the Miller Box Company, a partnership, and knew that George would be essential to his own continued participation in the manufacture of ammunition boxes. He exercised his business judgment, proven well-founded, to keep

George from leaving and competing, and in order to meet Rice's offer with a reasonable and comparable offer. (Twenty per cent of corporate profits before taxes would be fair and reasonable in comparison with 50 per cent of partnership profits after taxes.)

Approximately two months after the execution of the contract with George, James caused Miller Box, Inc. to be formed in February 1966. George agreed to the assignment of his contract with James to Miller Box, Inc., and took over with the corporation starting about March 1, 1966, the beginning of the corporation's fiscal year, the tax year in issue. The Board of Directors of Miller Box, Inc. assumed the obligations thereunder from its formation.

Implicit in the jury's verdict is that the contract between Miller Box, Inc. and George was the result of a free bargain, fair and advantageous to taxpayer, because (1) he was experienced and proficient in the box business, (2) he was considered indispensable to the success of the corporation, (3) he assumed to Miller Box, Inc. all his obligations under the contingent compensation contract without salary, at a time when there were no Government contracts and no one could foretell that Government contracts would be awarded or allocated to Miller Box, Inc. with the uncertainty of the duration of the Vietnam involvement and the low competitive bid requirement of Government procurement, (4) he bound himself contractually not to be employed by any other box manufacturer or competitor for a period of two years, (5) based on the Rice offer, a provision for 20 per cent of net profit before taxes under an employment contract without salary was fair and reasonable compensation to be paid him, (6) the percentage formula was agreed on before the work was performed.

The 5 per cent employment contract between Miller Box, Inc. and Gordon Miller, Jr. was entered into on March 28, 1966.

Gordon bought five per cent of the stock of Miller Box, Inc. at the time of its formation in February 1966, his father having been offered the opportunity of coming in as a stockholder and having turned it down as a bad gamble. Several days later, less than a month, he made an agreement with Miller Box, Inc. to sell back his five per cent stock interest. His father felt that this would be the best course to follow – not to gamble cash but to gamble services. His five per cent stock interest was sold back and the written employment contract of March 28, 1966 was executed. The board of directors of Miller Box, Inc. ratified the employment contract.

Implicit in the jury's verdict is that this contract was the result of a free bargain, fair and advantageous to Miller Box, Inc. because (1) Gordon had worked in the box business of Miller Box Company, the partnership, with over 10 years experience, (2) he would work exclusively for Miller Box, Inc. and not be employed without its permission or consent by any other box manufacturer or competitor for a period of two years, (3) he would work without a provision for salary, although he had been earning $200.00 per week plus 10 per cent of the partnership profits during his full time employment with the partnership over the past two years, (4) Miller Box, Inc. would be able to re-acquire his five per cent interest, (5) the percentage formula was agreed on before the services were performed.

Northport Box, Inc. — Employment Contracts

Northport Box, Inc. was incorporated in December 1966, the beginning of its first fiscal year, the year here in issue. On December 17, 1966, a contingent employment contract calling for 5% of net profits before tax was entered into with Gordon Miller, Jr. The 20 per cent employment contract between George Hinton and James Hinton of December 22, 1965 was transferred and assigned to the corporation. The separate parties to each of the contracts assumed

the obligations of each to the other. The Board of Directors of the corporation ratified both contracts.

Implicit in the jury's verdict is that the contracts were the result of a free bargain, fair and advantageous to the corporation because (1) the 20 per cent formula and the 5 per cent formula for contingent compensation to be paid George and Gordon, respectively, had been established as fair and reasonable based on their performance of duties and services at Miller Box, Inc. during the prior nine months of operation; (2) they had proven themselves highly efficient as a management team and this team would be continued; (3) the two plants could be operated almost as one with George as overall general manager and Gordon as plant manager of the new plant; (4) without them there would not have been a Northport Box, Inc.; (5) the percentage formula was agreed on before the work was performed.

Additional Factors

1. George Hinton, as general manager of Miller Box, Inc. and also as general manager of Northport Box, Inc., and Gordon Miller, Jr., as assistant general manager of Miller Box, Inc. and nine months later as plant manager of Northport Box, Inc., assumed full responsibility for the operation of the two plants and spent substantially all of their time and effort working for them. Their activity and diligence and the valuable services they rendered are detailed in the opinion of the Court of Appeals (Appendix A, infra, p. 17). It was primarily through their joint management efforts that the large profits were made and the two corporations were highly successful during the first year of operation of each.

2. The operations of Miller Box, Inc. and Northport Box, Inc. under their management were highly efficient. The percentage of profits to sales of Miller Box, Inc. was 21.4 per cent; the percentage of profits to sales of Northport

Box, Inc. was 28.3 per cent. The percentage of profits on sales of their principal competitors ranged from 6.8 per cent to 10.09 per cent. Miller Box, Inc. and Northport Box, Inc. were much more efficient operators than their principal competitors.

3. The compensation paid to George and Gordon had a reasonable relationship to the gross income and net income of the two taxpayers. The gross sales of Miller Box, Inc. for the year were $3,449,636. The gross sales of Northport Box, Inc. for the year were $3,805,820. Based on the 20 per cent and 5 per cent formula the net earnings, before taxes, for the year of Miller Box, Inc. were approximately $1,000,000 and of Northport Box, Inc., approximately $1,400,000.

4. The prevailing general economic condition was one of uncertainty and indefiniteness. No one could foretell how long government demand for ammunition boxes would last. Without government procurement, both corporations would fold, profits would cease and these employees would be paid no compensation. It was common knowledge that the United States Government desired an immediate end, with honor, to its Vietnam involvement.

5. Salaries paid by taxpayers to other employees, and paid by comparable firms engaged in the box manufacture business, the principal competitors of taxpayers here, were not paid pursuant to contingent employment contracts.

6. The compensation paid under the employment contracts was not in relation to stock ownership and was not a disguised dividend. Gordon and his family owned no stock in either corporation. George owned a five per cent stock interest in both corporations. The taxable year was the first year of operation of each corporation. There had been no discussion about dividends as it was not known what the profits were. James Hinton, who owned a 75 per cent stock interest in each corporation, received no salary from either corporation.

REASONS FOR GRANTING THE WRIT

I. The Court of Appeals has Decided a Federal Question in a Way in Conflict with Applicable Decisions of this Court, in Directing Entry of Judgment in Favor of the Verdict Loser, who Failed Timely to File in the Trial Court a Motion for Judgment Notwithstanding the Verdict.

The decisions of the Court are uniform in holding that an Appellate Court may not order entry of a judgment notwithstanding the verdict of the jury where the verdict loser has failed strictly to comply with the procedural requirements of Rule 50 (b), Federal Rules of Civil Procedure.

Neely v. Martin K. Eby Construction Co.,
386 U.S. 317, 87 S.Ct. 1072

Johnson v. New York, N.H. & H.R. Co.,
344 U.S. 48, 73 S.Ct. 125

Globe Liquor Co. v. San Roman,
332 U.S. 571, 68 S.Ct. 246

Cone v. West Virginia Pulp & Paper Co.,
330 U.S. 212, 67 S.Ct. 752

The time requirement of Rule 50 (b) is that the verdict loser must make its motion for judgment notwithstanding the verdict within 10 days after entry of judgment. The verdict in the trial court was returned and received September 6, 1972. The government's motion for judgment notwithstanding the verdict was filed in the trial court on September 18, 1972. No motion was made by the government after entry of judgment on November 7, 1972.

Mr. Justice White, in the opinion in the *Neely* case, supra, reviewing the prior decisions of the Court, states the applicable law:

> "Under Rule 50 (b), if a party moves for a directed verdict at the close of the evidence and if the trial

> judge elects to send the case to the jury, the judge is 'deemed' to have reserved decision on the motion. If the jury returns a contrary verdict, the party may within 10 days move to have judgment entered in accordance with his motion for directed verdict. * * *"
>
> "The opinions in the above cases make it clear that an appellate court may not order judgment n.o.v. where the verdict loser has failed strictly to comply with the procedural requirements of Rule 50 (b), * *" (286 U.S. at 321, 325).

It is submitted that this requirement of a timely application after entry of judgment is not an idle motion, but is an essential and well established part of Rule 50 (b). The Court of Appeals, therefore, was precluded from directing any disposition other than a new trial.

II. The Decision Below Puts the Courts of Appeal for the Fifth and Sixth Circuits in Clear Conflict with Respect to a Question of Sufficiency of Evidence, Important to the Administration of the Federal Income Tax Laws. The Court Should Resolve this Conflict.

The decision of the Fifth Circuit in this case is in conflict with the decision of the Sixth Circuit in *Mayson Manufacturing Co. v. Commissioner of Internal Revenue,* 178 F.2d 115 (1949). In both cases there was presented the legal question of what evidence is sufficient to sustain a determination under Section 162 (a) (1), Internal Revenue Code, of the reasonableness of compensation paid under contingent employment contracts and what factors should be considered by the fact-finder. The thrust of the opinion of the Fifth Circuit is that (1) there must be opinion evidence that the compensation paid under the contingency formula contained in the employment contracts was reasonable; and (2) there must be evidence of comparable compensation paid by comparable or competitive firms.

In the *Mayson* case the Sixth Circuit held that no one factor is decisive to a fact finder's determination of reasonable compensation. Eleven basic factors are cited as relevant and material. In that case, May and Peterson, in addition to their basic salaries respectively of $24,000 and $12,000, were paid, pursuant to an established plan, incentive compensation amounting to 25 per cent of the annual net profits, three-fourths to May and one-fourth to Peterson.

The Tax Court held that the compensation paid was not allowable as a reasonable compensation deduction. The Sixth Circuit reversed, holding that the contingent plan of compensation was an arms-length transaction, and that compensation paid thereunder may be larger in a successful year "where the incentive principle of compensation has been fairly entered into between the parties". The Court cited with approval the *Gray* case that "the policy of agreeing to pay a percentage of earnings before they are earned is based primarily upon sound business principles".

The Court pointed out that evidence showing what compensation other companies engaged in the same type of work paid for comparable services is only one of several factors to be considered and refers to the fact, present here, that "other companies comparable in size may not have used the incentive system of compensation". The principle, that action of Board of Directors in approving employee compensation is entitled to the presumption that such compensation is reasonable, was given approval.

The Court gave substantial weight to the fact that the officers were experienced, highly qualified and able executives. Each one performed the duties in his respective field in a very successful manner and gave unlimited time and effort to the duties and problems of the business. The company was very successful under their joint management. The Court referred to the *Roth* case, holding that the

fortuitous circumstances of a war economy does not alone establish unreasonableness.

The factors, which are set forth in *Mayson*, evidence of which were presented to the jury in the trial court but given no weight or credence by the Fifth Circuit, are summarized:

1. These two employees were experienced and highly qualified in the manufacture of ammunition boxes.

2. Each one performed the duties in his respective field in a highly successful manner and during the respective tax year in issue of the two taxpayers gave unlimited time and effort to meeting their duties and problems as they arose and increased. Working together, they produced a percentage of profits to sales two to three times greater than their principal competitors.

3. The two taxpayers during the first year of operation grew in size from zero to gross sales of $3,449,636 and $3,805,820, respectively, due primarily to the dynamic management efforts of the two employees.

4. Combined compensation of the two employees was less than ten per cent of the gross income of each taxpayer, and, combined, equalled twenty-five per cent of the earned net income of approximately $1,000,000 of Miller Box, Inc. and of approximately $1,400,000 of Northport Box, Inc.

5. Because of the Vietnam involvement, the general economic condition, particularly in the ammunition box business, was one of uncertainty and indefiniteness. Overnight, government procurement might terminate.

6. No distributions to shareholders were made because it was the first year of operation of each taxpayer and it was not known what the profits would be. George Hinton owned a five per cent stock interest in each corporation. Gordon Miller, Jr. owned no stock in either corporation.

7. None of taxpayers' principal competitors had contingent employment contracts for comparable positions; where the employees took the risk of receiving no compensation.

8. The salary policy of the taxpayers as to their other employees was on the basis of fixed salaries. None worked under contingent employment contracts.

9. There was no previous year experience in paying compensation. The two tax years were the first year of operation of each of taxpayers.

10. The percentage formula was agreed on before the services were rendered. The percentage formula of George Hinton was comparable to the percentage formula offered him by a potential competitor.

11. The employment contracts were negotiated at arms-length, were fair and advantageous to each employer. They were so found by the boards of directors in ratifying same and by the jury in its verdict.

See *Harold's Club v. Commissioner*, 9 Cir., 340 F.2d 861, 865, holding that the question of whether the "compensation agreement resulted from a 'free bargain' is one of fact."

CONCLUSION

The genesis of a taxpayer's right to jury trial in the United States District Courts is the Seventh Amendment, Constitution of the United States. Trial by jury in civil cases ranks high in the catalogue of constitutional safeguards. A right so fundamental and sacred should be jealously guarded. If a jury verdict is exiled summarily by a Court of Appeals, acting as fact-finder upon re-examination of the facts, trial by jury will inevitably become a museum relic. The established law is:

> "We might agree with the Court of Appeals had the questions of fact been left to us. But neither we nor the Court of Appeals can redetermine facts found by

the jury any more than the District Court can predetermine them."

Atlantic & Gulf Stevedores, Inc. v. Ellerman Lines, 369 U.S. 355, 358, 359; 82 S.Ct. 780, 783 (1962)

On at least three occasions this Court has granted the petition for writ of certiorari and entered per curiam reversals when the Fifth Circuit has substituted its views of the sufficiency of the evidence for those of the jury. This precedent should be followed here.

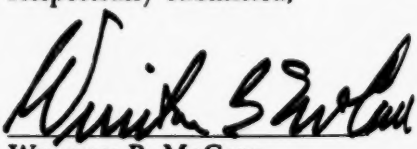
Williams v. Carolina Life Ins. Co., 348 U.S. 802, 75 S.Ct. 30 (1954) rev. 5 Cir., 210 F.2d 477

Swafford v. Atlantic Coast Line R. Co., 350 U.S. 807, 76 S.Ct. 80 (1955) rev. 5 Cir., 220 F.2d 901

Gibson v. Phillips Petroleum Co., 352 U.S. 874, 77 S.Ct. 16 (1956) rev. 5 Cir., 232 F.2d 13.

WHEREFORE, the petition for writ of certiorari should be granted.

Respectfully submitted,

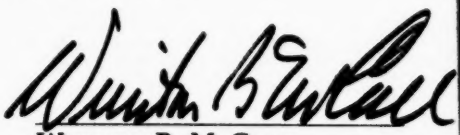


WINSTON B. MCCALL
831 Frank Nelson Building
Birmingham, Alabama 35203
Attorney for Petitioners

CERTIFICATE OF SERVICE

It is hereby certified that service of this Petition has been made on opposing counsel by mailing three copies thereof this 26 day of March, 1974, with first class postage prepaid, addressed to him as follows:

Solicitor General
Department of Justice
Washington, D. C. 20530



WINSTON B. MCCALL

APPENDIX A

OPINION OF THE COURT OF APPEALS INDEXED

MILLER BOX, INC. and Northport Box, Inc., Plaintiffs-Appellees,

v.

UNITED STATES of America, Defendant-Appellant.

No. 73–1388.

United States Court of Appeals, Fifth Circuit.

Jan. 23, 1974.

Suit by corporations for refund of taxes paid after Internal Revenue Service determined that compensation paid to employee, for which corporations took deductions, was unreasonable. The United States District Court for the Northern District of Alabama at Birmingham, Sam C. Pointer, Jr., J., entered judgment determining that payments to employee were deductible and the government appealed. The Court of Appeals, Tuttle, Circuit Judge, held that jury verdict determining that salaries totalling $1,143,041 over two-year period paid to manager of two box manufacturing corporations completely controlled by manager's brother, in addition to salary of $24,000 paid to him as manager of a partnership box manufacturing company, were reasonable, was not supported by evidence, notwithstanding claim that payments were made pursuant to contracts to manage corporations for 20% of net profits, and director's determination as to reasonable salary would be deemed correct.

Reversed and remanded.

Synopses, Syllabi and Key Number Classification
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The Synopses, Syllabi and Key Number Classification constitute no part of the opinion of the court.

1. Master and Servant ⇐3(2)

Contract between brothers, one of whom controlled two corporations, that other brother would be compensated as manager at 20% of net earnings was not an obligation of the corporations.

2. Internal Revenue ⇐2127

Determination by Internal Revenue Service commissioner on reasonableness of compensation of employee of corporation, for purpose of deduction as business expense, is deemed to be correct and taxpayer has burden of overcoming that determination as to what is a reasonable amount. 26 U.S.C.A. (I.R.C. 1954) § 162.

3. Internal Revenue ⇐2166

Jury finding that compensation paid by corporation to employee was reasonable and deductible as business expense could not be based on proof that employee worked long hours for the corporation and for a related corporation and partnership, without differentiating between the services performed for each period. 26 U.S.C.A. (I.R.C.1954) § 162.

4. Internal Revenue ⇐548

As bearing on reasonableness of compensation paid in 1967 and 1968 to employee of corporations controlled by employee's brother, contracts between brother and employee calling for employee to manage businesses for 20% of net profits were not to be viewed as of December, 1965, when the first contract was executed. 26 U.S.C.A. (I.R.C.1954) § 162.

5. Internal Revenue ⇐548

It is the duty of the directors of the corporation, so far as deductibility for tax purposes is concerned, to bargain with an employee for fair and advantageous terms to obtain the services of such individuals. 26 U.S.C.A. (I.R.C.1954) § 162.

6. Internal Revenue ⇐2166

Jury finding that salaries totalling $1,143,041 over two-year period paid to general manager of two box manufacturing corporations completely controlled by manager's brother,

in addition to salary of $24,000 paid to him as manager of a partnership box manufacturing company, were reasonable and thus deductible by the corporation, as against IRS determination that reasonable compensation for services for 1967 was $60,000 to be paid by one corporation and $30,000 to be paid by second corporation and that reasonable compensation for 1968 would be $60,000, was not supported by the evidence. 26 U.S.C.A. (I.R.C.1954) §§ 162, 531.

Appeals from the United States District Court for the Northern District of Alabama.

Before TUTTLE, DYER and MORGAN, Circuit Judges.

TUTTLE, Circuit Judge:

The government appeals from a judgment based upon a jury verdict which determined that salaries totalling $1,143,-041 over a two year period paid to the general manager of two box manufacturing *corporations* completely controlled by his brother, in addition to a salary of $24,000 paid to him as manager of a *partnership* box manufacturing company, were reasonable and thus deductible by the corporations as a part of their operating expenses. The government's appeal is based solely upon its contention that the trial court erred in not ordering a directed verdict or entering a judgment n. o. v. in its favor.

The question arises because of the provisions of the Internal Revenue laws. Section 162 of the Internal Revenue Code of 1954 (26 U.S.C.A. § 162) provides:

"A. *Section 162: Trade or Business Expenses.*

(a) In General—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during

the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered; . . ."

Before discussing the standard to be applied by the trial court in the granting of a judgment n. o. v., as set out by this Court in Boeing Company v. Shipman, 411 F.2d 365 (5 Cir., 1969), we think it necessary to outline a little more precisely the relationships and the history of the corporations and partnership, as well as the persons involved.

In 1948 Garden Miller, Sr., and James Hinton, organized a partnership, which was owned 50 per cent by Miller, 45 per cent by the James Hinton family and 5 per cent by George Hinton (the employee whose salary later raised the litigated issues before the court). The partnership was engaged in the manufacture of wooden boxes and boxes designed to carry ammunition. By late 1965, the war in Viet Nam was increasing, and the business of Miller Box partnership was increasing, and it was "getting more successful in securing contracts and . . . [was] getting bigger and more contracts," and "the outlook in the industry was good." In December 1965 James Hinton entered into a contract with his brother, George Hinton, to become the manager of a box plant that either James or a corporation organized by him would build. The contract called for George to be compensated on the basis of 20 per cent of the net earnings of the plant, before taxes, with no minimum guarantee. At that time George Hinton was the manager of the partnership's plant, earning a salary of $7600. He also owned and operated a farm in the area.

As of March 1, 1966, James Hinton caused Miller Box, Inc. to be formed. He retained 75 shares of the stock totalling 100 shares. Garden Miller, Jr., the son of James' partner, originally owned five shares, which he later disposed of to the company. Thereafter, James Hinton owned 75 shares, George Hinton 5 shares, and Paul W. Bryant, football coach of the

University of Alabama, owned 20 shares.[1] A plant had been built and equipped with the necessary machinery for about $100,000, and the taxpayer, Miller Box, Inc., commenced its operations on March 1, 1966. When fully operative it employed about 200 people. George Hinton undertook his duties as general manager of the new corporation, continuing to be general manager of the partnership's plant. In the taxpayer's complaint, in its suit for refund, which is the suit that is now before the court, the taxpayer, Miller Box, Inc., alleged that the salary paid George L. Hinton, Jr. "was paid pursuant to a bona fide contract entered into in *December, 1965,* whereby 20 per cent of net earnings before taxes was to be paid as his compensation." (Emphasis added.) The only contract entered into in December 1965 is Exhibit No. 1, tendered in evidence on behalf of taxpayer. This is the contract mentioned above, which is made not between the taxpayer and George Hinton, but between James Hinton, an individual, and his brother, George, before taxpayer was incorporated.

At the time George Hinton undertook the management of the taxpayer's new plant, Mary Jean Hinton, a sister of James and George, was named "plant manager" (for which she received a salary in fiscal 1967 of $14,200, and in 1968 a salary of $30,200) and Garden Miller, Jr., the son of Miller of the Miller Box Company partnership, was named assistant plant manager under a contract which provided him with a salary that equalled 5 per cent of net profits before taxes and before deduction of George Hinton's salary (Miller's salary under this formula amounted to $49,343 for fiscal 1967).

The new corporation prospered, largely undoubtedly through the efforts of George Hinton and Garden Miller, Jr., and the success of the partnership in obtaining profitable

1. A copy of the minutes of a stockholders' meeting in November 1966 certified that the only stockholders were James Hinton and George Hinton. It is not clear when or how Mr. Bryant became a stockholder. At the November meeting he was given a contract of employment by the corporation at $60,000 per year, primarily to assist in procuring lumber. He was then elected a director.

contracts, but the partnership, Miller Box, was obtaining government contracts for the manufacture of ammunition boxes faster than they could be produced by the partnership's plant and Miller Box, Inc.'s new plant. Thereupon James Hinton decided that he would organize an additional corporation to be known as Northport Box, Inc. This corporation was organized to begin business on December 1, 1966, whereupon George Hinton became general manager of that corporation as well. Northport was a *smaller* plant employing "about 130" employees. Again, it is alleged in the claim for refund that he acquired this position with Northport Box, Inc. "pursuant to a bona fide contract entered into in December 1965, whereby 20 per cent of net earnings before taxes was to be paid as his compensation."

Garden Miller, Jr. also assumed a dual role, this time by becoming "plant manager" of Northport Box, Inc. His 5 per cent contract with Northport produced a salary for fiscal 1967 of $71,951, which, when added to the salary that he received while working simultaneously for Miller Box, Inc., equals $121,294.

George Hinton's salary from Miller Box, Inc., the *larger* plant, for the year ending February 28, 1967, amounted to $197,372. His salary from Northport Box, Inc., the *smaller* plant, for the year ending November 30, 1967 amounted to $287,805. His salary from Miller Box, Inc. for the fiscal year ending February 29, 1968 amounted to $657,845. When there is added to this the sum of $24,000, Mr. Hinton's minimum estimates as to the salary he received from the *partnership* for managing its plant as general manager as well, we find that his services were compensated during the two fiscal years involved by payments to him of $1,167,022.

Under his 5 per cent contract, Garden Miller, Jr. received $49,343 from Miller Box, Inc. for fiscal 1967, $71,951 from Northport Box, Inc. for fiscal 1967, and $164,461 from Miller Box, Inc. for fiscal 1968. (This amount was disallowed by the trial court on motion n. o. v. apparently because there was *no*

proof that Miller performed any specific services for this corporation in 1968.)

One essential fact to be constantly borne in mind is that Miller Box Company, the partnership consisting of Garden Miller, Sr. and James Hinton, obtained all of the government contracts for the making of the boxes by the several plants. The partnership ran at full capacity at its own plant; it then allocated to Miller Box, Inc. contracts which enabled it to operate on a two-shift schedule until need for further capacity caused Mr. Hinton to incorporate Northport Box, Inc. Thus, we have the interrelationship of James Hinton and Garden Miller, Sr. obtaining and allocating business to two corporations, which, in turn, paid the compensation here under attack to the brother of one partner and the son of the other.

The only documentary evidence relating to the several contracts consisted of (1) contract executed in December 1965 between James Hinton and his brother, George, under the terms of which it was mutually agreed that George would devote his time and energies to the operation of box manufacturing plants to be provided by James either directly or by the organization of a corporation, and that the compensation to be paid to George would amount to 20 per cent of the net profits before taxes; (2) a contract executed on March 28, 1966 between Miller Box, Inc. and Garden Miller, Jr. to run for an indefinite period of time commencing on the date of his contract and continuing thereafter on a month to month basis with no action of either party necessary to the continuation of this employment agreement, the compensation for such services to be 5 per cent of the net profits prior to taxes and prior to the consideration of compensation to be paid to George Hinton, Jr.; (3) minutes of a special meeting of stockholders and directors of Miller Box Company, dated November 18, 1966, authorizing the employment of Paul W. Bryant by Miller Box, Inc. at a salary of $60,000 a year, and electing the said Bryant to the Board of Directors of the corporation; (4) contract dated November 23, 1966 between Miller Box, Inc.

and Paul W. Bryant, engaging his services to run until terminated by thirty days notice by either party at $60,000 per year; (5) contract dated December 17, 1966 between Northport Box, Inc. and Garden Miller, Jr. for compensation to be computed at 5 per cent of the net profits before taxes and before compensation paid to George Hinton (it was under this contract of employment that Miller became plant manager of Northport Box, Inc.).

No written contract was introduced showing the employment by either of the two corporations of George Hinton. Neither is there in evidence any assignment of Hinton's contract with his brother, James, entered into on December 15, 1966. There is no evidence in the record as to when the corporations actually made a contractual relationship with George Hinton, other than the fact that he undertook the duties of general manager and was paid a salary based upon the agreed percentage formula. In response to questions by counsel at the trial, Mr. James Hinton testified as follows:

Q. Now, Mr. Hinton, with respect to the contract with Garden Miller and George Hinton, those contracts were taken off by both Northport Box and Miller Box and ratified and transferred—transfer was ratified by the Board of Directors of each corporation?

A. That is correct.

Q. And the corporations assumed the obligations of these parties, and did they assume the obligations to perform for both corporations under those contracts?

A. That is correct.

[1] Taxpayers did introduce minutes of a directors meeting authorizing the employment of Mr. Bryant at $60,000 per year. In the absence of any similar proof of Board action with respect to George Hinton, presumably, the witness meant that the corporations simply acted with respect to George Hinton as if the original contract between the Hinton brothers had been their own obligation, which, of course, it was not.

No dividends were either considered or declared by either corporation for the fiscal years 1967 or 1968.

While the case originated with a suit for refund for an alleged overpayment of taxes by the two corporations for the two fiscal years 1967 and 1968, the trial court separated the year 1968 for the purpose of making a final judgment in favor of the taxpayers, and we have here for consideration only an appeal from the judgment affirming the jury's verdict with respect to the reasonableness of the 1967 salaries for George Hinton and Garden Miller. The Internal Revenue Service contended that Miller Box, Inc. unreasonably accumulated surplus in the year 1968 within the concept of Section 531 of the Internal Revenue Code, and, since that issue was delayed by virtue of renegotiation proceedings pending against the company, the trial court did not enter a final judgment on the jury's verdict that George Hinton's salary of $657,845 for fiscal 1968 was deductible. However, since the two years were tried together, and since the trial court has already by order, though not in final form, approved the jury's finding as to the 1968 salary paid to George Hinton, we have included statements concerning this item because we consider it relevant to the whole question of reasonableness of the 20 per cent contingent salary which Miller Box, Inc. was paying to George Hinton.

We deal here with a jury verdict approved by the trial court, and adhered to by the trial court upon the denial of a petition for judgment as to the 1968 amount n. o. v., but which the trial court has not made the basis of a final judgment allowing recovery by the corporate plaintiff for 1968 in the refund suit, pending further proceedings not related to the salary question dealing with the 1968 fiscal year.[2]

2. Following the jury's answers to special interrogatories that George Hinton's salary payments by Miller Box, Inc., of $197,372 for the fiscal year ending February 28, 1967, and by Northport Box, Inc. of $287,805 for the fiscal year ending November 30, 1967, and by Miller Box, Inc. of $657,845 for the fiscal year ending February 29, 1968 were "reasonable compensation" the government filed its motion for

The issues were drawn in this case by the disallowance by the Internal Revenue Service of the amounts of compensation shown. The Director determined that reasonable compensation for the services of George Hinton for fiscal 1967 was $60,000, to be paid by Miller Box, Inc., and $30,000 to be paid by Northport Box, Inc. The Director found that reasonable compensation for Garden Miller, Jr., for the year 1967, would be $41,000 by Miller Box, Inc., and $41,000 by Northport Box, Inc. The Director also found that reasonable compensation for fiscal 1968 for George Hinton would be $60,000.

The burden is on the taxpayer to prove the correctness of claimed deductions.

[2] This may also be expressed by saying that a determination by the Commissioner on the reasonableness of compensation is deemed to be correct and the taxpayer has the burden of overcoming that determination as to what is a reasonable amount. *See* Botany Mills v. United States, 278 U.S. 282, 49 S.Ct. 129, 73 L.Ed. 379 (1928); Miles-Conley Co. v. C. I. R., 173 F.2d 958, 960 (4th Cir. 1949).

The standard by which a trial court determines whether a motion for directed verdict or for judgment notwithstanding the verdict should be entered has been stated by this court in Boeing Company v. Shipman, *supra*, 411 F.2d at 374, where this court said:

> On motions for directed verdict and for judgment notwithstanding the verdict the Court should consider all of the evidence—not just that evidence which supports the nonmover's case—but in the light and with all reasonable

judgment n. o. v. as to each amount to the extent that it exceeded the salaries determined by the Commissioner to be reasonable; these amounts are discussed later. The trial court entered an order denying this motion and made an adjudication in favor of the respective taxpayer corporations for tax refunds for both 1967 and 1968, but withheld entering a *final* judgment for 1968 pending resolution of the section 531 claim of the government.

inferences most favorable to the part opposed to the motion. If the facts and inferences point so strongly and overwhelmingly in favor of one party that the Court believes that reasonable men could not arrive at a contrary verdict, granting of the motions is proper. On the other hand, if there is substantial evidence opposed to the motions, that is, evidence of such quality and weight that reasonable and fair-minded men in the exercise of impartial judgment might reach different conclusions, the motions should be denied, and the case submitted to the jury. A mere scintilla of evidence is insufficient to present a question for the jury. The motions for directed verdict and judgment n. o. v. should not be decided by which side has the better of the case, nor should they be granted only when there is a complete absence of probative facts to support a jury verdict. There must be a conflict in substantial evidence to create a jury question.

The nature of the proof in such a case as this must be viewed in light of Treasury Regulations dealing with Sections 162, quoted above. Because of the significance of these Regulations to the determination of the case we quote them here in full:

B. Treasury Regulations on Income Tax, 1954 Code (26 C.F.R.): *Section 1.162–7: Compensation for Personal Services.*

(a) There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.

(b) The test set forth in paragraph (a) of this section and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services and the excessive payments correspond or bear a close relationship to the stockholdings of the officer of employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. . . .

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like

> enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contrace is questioned.

A careful reading of the record in this case convinces us that all of the evidence with all reasonable inferences most favorable to the taxpayers that can be drawn therefrom does not rise to that *modicum* of evidence described as "substantial" so as to require submission of the issue to a jury. We conclude, therefore, that the trial court erred in denying the motion for directed verdict and, thereafter, for denying the motion for judgment n. o. v. filed by the government.

[3] It is apparent that the affairs of James Hinton, Garden Miller, Sr., and George Hinton, who operated the partnership Miller Box, the corporation Miller Box, Inc. and the corporation Northport Box, Inc., (both of which were completely dominated by James Hinton) were treated casually and informally. All parties seem to have overlooked the fact that once Miller Box, Inc. and Northport Box, Inc. were incorporated each of them became completely separate entities subject to the requirement that they operate within the requirements of the provisions of the Internal Revenue laws respecting the limitations placed on them as to amounts that could be deducted for services of officers and employees as a part of the expense of operation. It would be impossible for the jury to make a finding that compensation paid by Miller Box, Inc. was reasonable merely by proof that George Hinton worked very long hours six or seven days a week for Miller Box, Inc. *and* Northport Box, Inc. *and* Miller Box, the partnership, without differentiating between the services performed for each. The same, of course, is true as to Northport Box, Inc. It had its own obligation to establish the fact that the salary paid to George Hinton was both reasonable and for services actually rendered to it. This could not be done by showing the tremendous activity testified to by James Hinton and

George Hinton as to the latter's work habits dealing with the problems of the partnership, Miller Box, Inc., Northport Box, Inc. and his 400 acre farm which according to his testimony he visited once or twice a month.

The significance of the need to present evidence to the fact finder to support a claimed deduction for compensation by each of George Hinton's employers separately is made plain from the fact that he was paid $197,372 as general manager of Miller Box, Inc. a corporation employing 200 employees and he was paid as general manager of Northport Box, Inc. a salary of $287,805 although this was a plant with 130 employees and was not incorporated until nine months after Miller Box, Inc. had been operating on a rising demand for ammunition boxes because of the escalation of the Viet Nam War.

The need for differentiating the obligations of the separate corporations to justify their deductions for salaries is further glaringly illustrated by the fact that the jury was permitted to consider the issue of reasonableness of Garden Miller, Jr.'s salary of $164,461 paid to him for the fiscal year 1968 by Miller Box, Inc. at a time when he was no longer assistant plant manager of that corporation but was plant manager of Northport Box, Inc. and there was an utter lack of evidence as to services performed by him for Miller Box, Inc. This amount was set aside by the trial court on a motion for judgment n. o. v.

We consider it putting the matter mildly to state that the court's credulity would be gravely taxed if it were argued seriously that any person, no matter how qualified and no matter how hard working, who was not in a position of close family relationship to the owners of a business would have been able to benefit from a contract, terminable at will, which earned him such astounding sums as were paid to George Hinton and Garden Miller, Jr. for their services in managerial capacities of these two box manufacturing companies. It must be remembered that in addition to these two persons both corporations had a full panoply of plant managers,

superintendents, foremen and the like as readily testified to be George Hinton. It must also be borne in mind that neither of these officials had the responsibility of obtaining the contracts from the government, although they testified that they helped prepare the figures to enable the partnership to bid on the contracts. The business was obtained solely by the partnership consisting of the brother of George Hinton and the father of Garden Miller, Jr. and parcelled out by it to the two corporations which then paid out these tremendous salaries to the two employees.

[4] The taxpayers' principal contention to support these large deductions is that the contract entered into in December, 1965 was a contingent percentage contract, and that the fact that the percentage of profit proved out to be so enormous was purely fortuitous and was not to have been anticipated because no one knew how profitable the business was going to be. While we do not intend to invade the province of the fact finder, and although it is not necessary to our conclusion in this case, because of the lack of evidence to support the reasonableness of the compensation, we think it is important to point out the following facts: The contracts are to be viewed *not* as of December, 1965 but, as it relates to the Miller Box, Inc. salary agreement with George Hinton, as of a date no earlier than March 1, 1966, and possibly later, and no earlier than December 1, 1966 as to the employment "contract" with Northport Box, Inc. because that is the date on which the latter taxpayer started business. The same is substantially true with respect to the employment of Miller. The employment contract between him and Miller Box was not signed until March 28, 1966 and that with Northport was executed on December 17, 1966. Before obligating themselves to pay salaries that were as open ended as these were, if they intended to deduct the amounts paid for corporate income tax purposes, they were required to determine what was reasonable compensation, "fair and advantageous" to them as corporations (Regs. 1.162–7(b)(2) *supra*).

The absence of recorded formal action with respect to the authorization of the contract for compensation paid to George Hinton and the absence of any showing as to when the stockholders or directors gave the appropriate consideration to a determination of what would be reasonable makes it impossible to know exactly when George Hinton's contract of employment at 20 per cent of profits before taxes was actually made a legally binding determination by the taxpayer. It is clear that at the time Miller Box, Inc. started its operation, it did so because of the fact that the partnership had more business from the United States Government than it was able to handle in its then existing plant. It is clear from the evidence that Garden Miller, Jr.'s contract was formally executed by Miller Box, Inc. on March 28, 1966, which, although during the first month of operation, was also at a time when the corporation which employed him had been brought into existence by persons holding contracts whose value had already been demonstrated. Even more, so far as employment by Northport Box, Inc. is concerned, both George Hinton and Garden Miller, Jr. were employed at least nine months after Miller Box, Inc. had been operating and after the partnership owners concluded that they had more business than could be handled both in the partnership plant and in the Miller Box, Inc. plant.

These comments are made to indicate that it is clear that the time for evaluating the employment contracts by these two corporations was *not* December, 1965.

In order that it may be clear that we have not failed to comprehend fully whatever strength may be said to lie in evidence on behalf of the taxpayer, we quote from the taxpayer's brief as to the performance of these two employees:

First, as to George Hinton:

> George Hinton went to work at six every morning and he was there at midnight to one o'clock getting home. He was available for phone calls from truck drivers all during the

night. On Saturdays and Sundays he generally worked shorter hours, 12 to 14 hours, which included working at Northport as well as Miller Box. He had to be at the plant around six in the morning to start one plant, and would get it started at seven and would then make his rounds to the other plant, running two shifts through 12:15. He was there practically every night until closing.

During the day he bought lumber, made new designs on machinery, new layouts to put the machinery and set up different lines. He also attended to his trucks which were running approximately 27 trucks and 35 to 40 trailers. He did his own hiring on truck drivers, made truck reports to the various states which they ran from Tuscaloosa to Illinois and from Alabama to Canada. He had authority to veto any hiring or firing of employees. He had to go to the arsenal quite often on reject boxes and on occasion drive the trucks for a rush load when the driver was out. He helped figure bids for government contracts. He scheduled production based on orders received and was in charge of packaging, dispatching and routing shipments to consignees. He ran the two plant sites and was on the management team for both plants. There were weekly, almost daily, conferences as to what was to be done at which plant.

Second, as to the services of Garden Miller, Jr. as assistant plant manager of Miller Box, Inc., and later in the year as plant manager of Northport Box, Inc.:

Garden Miller, Jr. performed services for Miller Box, Inc. primarily in connection with quality control, production control, and inventory control, helping and maintaining production. His work covered the inspection of boxes, maintenance of machines, development of new machines. He made suggestions as to the firing and hiring of certain employee personnel and made reports on difficulties with labor and their performance, trying to keep the labor costs down as much as possible. After he took over the additional duties as plant manager of the Northport Box plant, he

hired and trained personnel, supervised production, and worked closely with George Hinton, carrying out orders for George Hinton. He became an expert with inspection, which is always a problem with any manufacturing production, and he would go to the arsenal and get matters corrected. It was also his responsibility when machines were transferred from one place to another to see that the machinery was running correctly at both plants.

While he spent most of his time at Northport Box after becoming plant manager, he continued to spend a large amount of time at Miller Box, Inc. with problems regarding rejected boxes, new machines, helping to work new machines in the production line where they would be placed, and working out how much labor it would take to use them. He would also meet together there as a member of the management team for both plants and discuss the common problems that the two plants had. He held a B.S. degree from the University of Alabama with two majors—one in Industrial Management and one in General Business—and had worked in the box business for the partnership, Miller Box Company, during the prior approximately ten years, starting with summertime work and going to work on a full time basis in the summer of 1964.

While these excerpts from the appellees' briefs do not, of course, include every bit of evidence adduced on behalf of the taxpayers, it may properly be assumed that they do present the best case possible in support of their position. There should be added, however, with respect to the taxpayers' claim as to the reasonableness of George Hinton's salary the fact which was testified to on trial about the possibility of his having accepted an offer of a friend to go into a fifty-fifty partnership with him for the manufacture of boxes. The testimony further indicates that the December, 1965 contract between James Hinton and George Hinton was entered into as a means of persuading the latter not to consider seriously the proposition of his friend. There was no evidence as to the

likelihood that if such a new organization had been created it would have had any real success or opportunity in obtaining contracts for the box manufacturing as to which the partnership Miller Box had been so successful. It, therefore, is no evidence as to the value of George Hinton's services to the two corporations which were later organized.

Two additional facts should be noted with respect to Garden Miller, Jr. The first is that he was 23 or 24 years old, according to the year here dealt with at the time of his employment by these two corporations. At the time of the employment contract by Miller Box, Inc. with him he had been working for Miller Box, the partnership consisting of his father and James Hinton in their plant at wages of approximately $200 a week. Moreover, while counsel was justified in the quoted portion of the statement relating to Garden Miller's activities to say "he continued to spend a large amount of time at Miller Box, Inc.," this statement must be held to have been severely modified by Miller's own testimony on cross-examination during which the following occurred.

Q. Now your office after you became manager at Northport's plant, manager at Northport Box, Inc., your office was physically located at Northport, Inc., right?

A. Correct.

Q. But you would make maybe on the average one trip a week over to Miller Box, Inc., to coordinate-liaison, correct?

A. One trip a week would be hard to say. On an average I believe it would be more than that.

Q. Would it not be a true statement to say as follows, on the average you went to Miller Box, Inc. once a week, and you may stay a full morning or sometimes a longer or shorter period of time, would that be a fair statement, referring specifically to your time from Northport Box, Inc. when you were plant manager, how much time

you would spend over here, would that not be a fair and truthful and accurate statement sir?

A. It would certainly be approximation.

Q. Would it be an approximation that you would give the jury?

A. Yes.

There are two other matters as to which there can be no dispute, which we are satisfied must put a gloss on the generalized statements dealing with the duties of George Hinton and Garden Miller, Jr. These two corporations were not engaged in highly technical or complex operations of the kind sometimes dealt with by the tax court or the appellate courts in an effort to determine what might be reasonable compensation for management. *Cf.* Mayson Manufacturing Co. v. Commissioner of Internal Revenue, 178 F.2d 115 (6th Cir. 1949). The testimony of the principal entrepeneur of these three businesses, James Hinton showed very clearly that in the realm of the manufacturing industry the operation must be deemed a simple one. Mr. Hinton testified

> Well an ammunition box is a wooden box consists primarily wood. (sic) But it is assembled with nails, hardware used for—to put the top on to secure the top, rope handles to pick the box up, and primarily those are the ingredients making ammunition boxes . . .

Again, the evidence touching on the activities of George Hinton with respect to the purchasing of lumber must be viewed in light of the other fact that Miller Box, Inc. engaged Coach Bryant at a salary of $60,000 per year. In support of the taxpayer Miller Box, Inc.'s contention that this was a reasonable salary to be paid to him it adduced testimony that was undisputed to the effect that he was personally responsible for the obtaining of some million board feet of lumber and that but for his efforts the plant might have been shut down as much as 15% of the time.

Primarily, the difficulty with the taxpayers' case is that there is a recitation of undifferentiated activities for, and on behalf of, two entirely separate corporations each of which paid salaries in excess of those which the Commissioner determined to be reasonable under the circumstances. The evidence shows intense activity by George Hinton in the realm of long hours, which would normally be required if he held down two full time jobs.[3] The evidence did not indicate to what extent the activities described in the foregoing statement exercised by George Hinton were performed for the partnership in return for his $12,000 to $15,000 salary received from it. It must be borne in mind that the partnership itself was the obligated person under the contract with the government. There is no evidence that George Hinton's and Garden Miller's having to "go to the arsenal quite often on reject boxes" was to discharge an obligation of the partnership or for one taxpayer or the other.

In brief, there is nothing stated as to the activities of either of these employees that they did anything other than work full time in the day to day operations of any manufacturing plant, unless we consider the statement that "on occasion [George Hinton had to] drive the trucks for a rush load when the driver was out."

There is not a line of evidence in this record that seeks to put a money value either by estimate, opinion or demonstrated fact of any of the activities performed by these two employees. Not even the employees themselves undertook to testify that in their opinion the compensation paid them, even under the contingency formula, was reasonable. There was,

3. It is to be noted that the director does not undertake to say that the $60,000 salary determined by him to be reasonable compensation to be paid by Miller Box, Inc. is to be compensation for the full time devoted by George Hinton, for the Commissioner also found that the payment by Northport Box, Inc. of $30,000 for the same year would be reasonable and it is to be remembered that in addition he received a salary of between $12,000 and $15,000 from the partnership Miller Box.

of course, no proof offered by the taxpayers of comparable compensation arrangements by competitors or others in the same business.[4] The only such proof adduced by witnesses for the taxpayers came in cross-examination of Mr. James Hinton. In the course of this cross-examination he conceded that Northport Box, Inc. could have hired a plant manager at the time it engaged Garden Miller, Jr. (whose compensation for fiscal 1967 equalled $71,000) for $25,000 to $35,000 per year.

The significance of this is pointed up by language of the Board of Tax Appeals, the antecedent of the tax court, quoted with approval in Crescent Bed Co. v. Commissioner of Internal Revenue, 133 F.2d 424 (5th Cir. 1943) in an opinion written by Judge Sibley:

> The respondent [Director] has allowed salaries of $25,000 each to the two officers as a reasonable compensation for services rendered. It was petitioner's burden to demonstrate that such salaries were unreasonably small. This the record made at the hearing does not do. We have no evidence of salaries paid by comparable firms, nor any suggestion of proof that it would have cost more than $25,000 per year to replace either of the two officers. On the facts before us we hold that petitioner has not proven respondent's determination to be error. 133 F.2d 424, 425.

The government, in this case, saw fit to introduce into evidence executive salaries from comparable firms engaged in the box manufacturing business, firms which were conceded to be major competitors of the taxpayers here. The following tables summarize these payments.

Competitor	Chief Executive Officer	Plant Manager
Marvel Box Co.	$10,250–$13,500	$10,250–$12,000
Milan Box Co.	$37,750–$39,700	$37,750–$39,700

4. As will be pointed out later, the government did offer such evidence, but at this point we are dealing only with the absence of adequate proof by petitioners to overcome the presumption in favor of the Director's determination as to reasonable compensation.

Competitor	Chief Executive Officer	Plant Manager
Ozark Box Co.	$54,298–$65,246	
Bennett Box Co.	$100,000	$13,000–$32,500

[5] We think a further comment is in order, because of the stress placed by the taxpayers on the contingency feature of these employment contracts. It must be borne in mind that it is the duty of the Directors of the corporation, ordinarily placed on them by their obligation to the stockholders, but in any event placed on them so far as deductibility for tax purpose is concerned, by the Internal Revenue laws, to bargain with an employee for "fair and advantageous terms" to obtain the services of such individuals. Thus, Miller Box, Inc. had the obligation to make a fair and advantageous contract for the employment of George Hinton at whatever time (which is not disclosed in the record before us) it actually undertook to carry out the terms of the agreement made between James Hinton and George Hinton in December, 1965. It was under no obligation to hire George Hinton at all by reason of the personal agreement, because it was an entirely separate legal entity. Of course, the same is true of Northport. Moreover, the personal contract on its face does not appear to be for any certain term and, so far as appears, could be terminated at will.[5]

5. If Miller Box, Inc., acting through an independent Board of Directors, which of course it did not have, had determined to make an employment contract with George Hinton only at a flat salary of $60,000 a year and he had been willing to accept it he might well have had a suit against his brother James for not having carried out the obligations which James assumed in the 1965 contract, but this is a matter with which Miller Box, Inc., the taxpayer, is not concerned. The same, of course, is true, but to a much more significant extent, with respect to Northport Box, Inc. This corporation was organized after nine months of successful operation of Miller Box, Inc. Its success was assured at least to the extent that its incorporation represented the unqualified best judgment of all of the persons who had been engaged in this lucrative business for several years. The reasonableness of the contract made must be viewed as of that time, and entirely unrelated to whatever obligations James Hinton as an individual and George Hinton, his brother had undertaken towards each other a year previously.

[6] In sum, therefore, we are without doubt that there is complete absence of probative facts to support the jury ve dict as to the reasonableness of the amounts paid to Geor Hinton and Garden Miller, Jr. for either or both of t corporations for which they worked. This leaves no altern tive to this Court but to conclude that the Director's deter nation as to reasonable salaries for the persons and taxpaye concerned must stand.

The judgment of the trial court is reversed and the case remanded for further proceedings not inconsistent with t opinion.

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APPENDIX B

JUDGMENT OF THE COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1973

NO. 73-1388

D. C. Docket Nos. 70-209 & 72-99

MILLER BOX, INC. and NORTHPORT BOX, INC.,
Plaintiffs-Appellees,

versus

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeals from the United States District Court for the Northern District of Alabama

Before TUTTLE, DYER and MORGAN, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Alabama, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed; and that this cause be, and the same is hereby remanded to the said District Court for further proceedings not inconsistent with the opinion of this Court;

It is further ordered that plaintiffs-appellees pay to defendant-appellant, the costs on appeal to be taxed by the Clerk of this Court.

January 23, 1974

APPENDIX C

ORDER ON PETITION FOR REHEARING

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

OFFICE OF THE CLERK
February 22, 1974

TO ALL COUNSEL OF RECORD
Re: No. 73-1388 — Miller Box, Inc., et al v. U.S.A.

Gentlemen:

This is to advise that an order has this day been entered denying the petition( ) for rehearing, and no member of the panel nor Judge in regular active service on the Court having requested that the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure; Local Fifth Circuit Rule 12) the petition( ) for rehearing en banc has also been denied.

See Rule 41, Federal Rules of Appellate Procedure for issuance and stay of the mandate.

Very truly yours,

EDWARD W. WADSWORTH
Clerk
By /s/ SUSAN B. LEBRUN
Deputy Clerk

cc: Messrs. Scott P. Crampton
Meyer Rothwacks
John Murray
Lynn W. Ross, Jr.
Gary R. Allen
Messrs. William D. Mallard, Jr.
Charles D. Stewart
Mr. Winston B. McCall

APPENDIX D

STATUTE AND REGULATIONS

Internal Revenue Code of 1954 (26 U.S.C.) :

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

* * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) :

§ 1.162-7 *Compensation for personal services.*

(a) There may be included among the ordinary and necessary expenses paid or incurred in carrying on any trade or business a reasonable allowance for salaries or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services.

(b) The test set forth in paragraph (a) of this section and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services and the excessive payments correspond or bear a close relationship to the stockholdings of the officers or employees, it would seem likely that the salaries are not paid wholly for

services rendered, but that the excessive payments are a distribution of earnings upon the stock. An ostensible salary may be in part payment for property. This may occur, for example, where a partnership sells out to a corporation, the former partners agreeing to continue in the service of the corporation. In such a case it may be found that the salaries of the former partners are not merely for services, but in part constitute payment for the transfer of their business.

(2) The form or method of fixing compensation is not decisive as to deductibility. While any form of contingent compensation invites scrutiny as a possible distribution of earnings of the enterprise, it does not follow that payments on a contingent basis are to be treated fundamentally on any basis different from that applying to compensation at a flat rate. Generally speaking, if contingent compensation is paid pursuant to a free bargain between the employer and the individual made before the services are rendered, not influenced by any consideration on the part of the employer other than that of securing on fair and advantageous terms the services of the individual, it should be allowed as a deduction even though in the actual working out of the contract it may prove to be greater than the amount which would ordinarily be paid.

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is, in general, just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when the contract for services was made, not those existing at the date when the contract is questioned.

* * *

APPENDIX E

FEDERAL RULES OF CIVIL PROCEDURE, RULE 50 (b)

"*Motion for judgment notwithstanding the verdict.* Whenever a motion for a directed verdict made at the close of all the evidence is denied or for any reason is not granted, the court is deemed to have submitted the action to the jury subject to a later determination of the legal questions raised by the motion. Not later than 10 days after entry of judgment, a party who has moved for a directed verdict may move to have the verdict and any judgment entered thereon set aside and to have judgment entered in accordance with his motion for a directed verdict; or if a verdict was not returned such party, within 10 days after the jury has been discharged, may move for judgment in accordance with his motion for a directed verdict. A motion for a new trial may be joined with this motion, or a new trial may be prayed for in the alternative. If a verdict was returned the court may allow the judgment to stand or may reopen the judgment and either order a new trial or direct the entry of judgment as if the requested verdict had been directed. If no verdict was returned the court may direct the entry of judgment as if the requested verdict had been directed or may order a new trial."